

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re
KARL AND CHARLOTTE SCOTT,
Debtors.

Case No. 91-5-3276-MM
Chapter 7

**MEMORANDUM OPINION AND
ORDER THEREON**

INTRODUCTION

Before the Court is the debtors' Motion to Avoid Lien brought pursuant to 11 U.S.C. §§ 545(2) and 522(f) to set aside the tax lien of the State Board of Equalization. For the reasons set forth below, the debtors' motion is denied.

FACTS

Karl and Charlotte Scott filed a chapter 13 case on May 30, 1991, which was converted to chapter 7 on November 10, 1992. The case was closed without assets on May 3, 1993.

The Scotts were the general partners of Rainbow Trail Enterprises, a California Limited Partnership, which filed a chapter 7 case in November 1984. On April 16, 1985, the partnership filed a tax return reporting sales and use taxes for 1984, but did not pay its tax liability in the amount of \$1,241.77. The California State Board of Equalization ("SBE") asserted a claim in the partnership bankruptcy for the unpaid sales and use taxes and received a distribution of \$229 from the estate.

The SBE took no action against the Scotts to collect the partnership tax liability until

1 November 15, 1990, when the SBE filed a Notice of State Tax Lien in Santa Clara County. The
2 Scotts scheduled the SBE's claim as an unsecured, non-priority debt in their bankruptcy case. They
3 were granted a discharge on April 19, 1993.

4 The Scotts bring this motion pursuant to § 545(2) to set aside the SBE's tax lien on the basis
5 that the lien is unperfected or unenforceable. Alternatively, they assert that the lien should be avoided
6 pursuant to § 522(f) because it impairs their homestead exemption.

8 DISCUSSION

9 A. The Court May Reopen The Case Sua Sponte

10 As a preliminary matter, the court addresses the issue of reopening this closed case to hear the
11 motion filed by the debtors. Section 350(b) grants the court the authority and discretion to reopen a
12 closed case in order to administer assets, to accord relief to the debtor, or for other cause. In re
13 Beezley, 994 F.2d 1433 (9th Cir. 1993). A court may reopen a case sua sponte. In re Mullendore,
14 741 F.2d 306, 308 (10th Cir. 1984). Accordingly, the case is reopened for the limited purpose of
15 hearing the debtors' motion to avoid the SBE's tax lien.

16 B. The State's Lien Is Not Avoidable Under § 545(2)

17 1. Section 545(2) Voids Only Liens That Are 18 Unenforceable Under State Law

19 Section 545(2) of the Bankruptcy Code¹ applies to avoid liens that are unenforceable under
20 state law. Specifically, the section provides that a statutory lien is not effective against the claims of a
21 trustee in bankruptcy unless it is perfected or enforceable prior to the filing of the bankruptcy petition.
22 A lien is not perfected if a bona fide purchaser would receive title superior to the lienholder upon
23 transfer of the asset subject to the lien. Whether a lien is enforceable against a bona fide purchaser is
24 determined under state law. In re Loretto Winery Ltd., 898 F.2d 715, 718 (9th Cir. 1990).

25 The policy underlying section 545(2) supports the ratable distribution of the debtor's assets
26 among creditors. Id. State-created statutory liens may establish priorities that differ from the federal

27 ¹Unless otherwise noted, all subsequent section references are to Title 11 of the United States Code (the "Bankruptcy
28 Code").

1 scheme. A statutory lien arises solely upon the happening of specified circumstances or conditions
2 enumerated by statute. 11 U.S.C. § 101(53)(West 1993). Statutory liens commonly include tax
3 liens. See S. Rep. No. 989, 95th Cong., 2d Sess. 27 (1978); H.R. Rep. No. 595, 95th Cong., 1st
4 Sess. 314 (1977); 4 Collier on Bankruptcy ¶ 545.01[1] (15th ed. 1993). Historically, liens for taxes
5 which had accumulated over a number of years would consume an entire bankruptcy estate. See 4
6 Collier on Bankruptcy supra, ¶ 545.03[1].

7 Federal bankruptcy law recognizes that social, economic, or political policy sometimes
8 justifies deviations from the federal policy of ratable distribution. Loretto Winery, 898 F.2d at 718.
9 A state priority scheme will be upheld in bankruptcy if it is not preempted by bankruptcy law. Id. At
10 the heart of the federal priority scheme is the bona fide purchaser test, which determines perfection.
11 Bankruptcy law yields to state statutory liens that meet the criteria specified in § 545(2), requiring
12 perfection of the lien to prevail over a bona fide purchaser. Id.

13 **2. Under California Law, State's Lien Is Valid Although**
14 **A Personal Action Against Debtors Is**
Barred By The Limitations Period

15 The determinative issue under § 545(2) is whether the lien is valid under state law. The
16 debtor argues that the State of California's tax lien is unenforceable because the limitations period for
17 a personal action to collect the tax has expired. Under California law, a personal action to collect
18 taxes must be brought against a taxpayer within three years after the taxes become due and payable.
19 Cal. Rev. & Tax. Code § 6711 (West 1987). The partnership sales and use taxes became due and
20 payable in 1985. Since general partners are liable for the partnership's sales and use taxes, the SBE
21 could have commenced an action against the Scotts as individuals. Cal. Corp. Code § 15015 (West
22 1991). However, the limitations period has since expired, and the SBE cannot now maintain a suit
23 against the Scotts for collection of the delinquent taxes. Moreover, the Scotts have been granted a
24 discharge.

25 The crux of the issue before the Court is that a discharge precludes actions to establish the
26 debtor's personal liability on a debt and not actions to enforce a validly perfected prepetition lien
27 against property of the debtor. Long v. Bullard 117 U.S. 617, 620-21, 6 S.Ct. 917, 918, 29 L.Ed.
28 1004 (1886); In re Paepelow, 972 F.2d 730, 735 (7th Cir. 1992); 11 U.S.C. § 524. The Supreme

1 Court has acknowledged that liens and other secured interests survive bankruptcy unaffected.

2 Rather, a bankruptcy discharge extinguishes only one mode of
3 enforcing a claim - namely, an action against the debtor in
4 personam - while leaving intact another - namely, an action against
5 the debtor in rem.

6 Johnson v. Home State Bank, 501 U.S. ___, ___, 111 S.Ct. 2150, 2154, 115 L.Ed.2d 66 (1991).

7 See also Farrey v. Sanderfoot, 500 U.S. ___, ___, 111 S.Ct. 1825, 1829, 114 L.Ed.2d. 337
8 (1991).

9 This interpretation of the effect of a discharge under § 524 is consistent with other
10 sections of the Bankruptcy Code, such as § 506(d), which allows certain liens to pass through
11 bankruptcy unaffected, and § 522(c)(2), which provides that exempt property is still subject to
12 certain liens. Paeplow, 972 F.2d at 735. The question that remains to be considered is whether
13 the SBE's tax lien is valid notwithstanding that the debtors' personal liability for the taxes has been
14 discharged.

15 Under California law, a tax lien is created at the time a person fails to pay any amount that
16 is due and payable, including interest, penalties, and costs. Cal. Rev. & Tax. Code § 6757(a). It
17 is enforceable against all of the taxpayer's property, real and personal, tangible and intangible, and
18 all after-acquired property that belongs to the taxpayer and is located in the state, including the
19 taxpayer's dwelling. Cal. Gov't Code § 7170(a)(West 1980 & Supp. 1993). The SBE's lien arose
20 upon the taxpayers' failure to pay the delinquent taxes in 1985.

21 California courts have not addressed the distinction between the expiration of the
22 limitations period for personal actions against taxpayers (in personam actions) and the validity of a
23 lien securing payment of the overdue taxes (in rem actions). However, the Second District Court
24 of Appeals has recently ruled that the recordation of a notice of tax lien after the expiration of the
25 three year limitations period does not create or revive the period in which the State Equalization
26 Board can bring a personal action against the taxpayers. People v. Garg, 16 Cal. App. 4th 357,
27 20 Cal. Rptr. 2d 80 (Cal. Ct. App. 1993).²

28 ²The court in People v. Garg expressly reserved the issue of the validity of the lien in that case since the parties did not
present the issue. People v. Garg, 16 Cal. App. 4th at 364 fn. 6, 20 Cal. Rptr. 2d at 83 fn. 6.

Under California law, a tax lien on real property is perfected by recording a notice of lien at any time after the creation of the lien in the county where the real property is located. Cal. Gov't Code § 7171(a)(emphasis added). The lien is not valid against (1) successors in interest without knowledge, (2) holders of security interests, (3) mechanic's lienholders, and (4) judgment lien creditors, who acquired or perfected their rights prior to the recording of the notice of lien. Cal. Gov't Code § 7170(b). The SBE perfected its lien prepetition by recordation on November 15, 1990. Pursuant to the plain provisions of the California tax statutes, the SBE has a properly perfected lien that is valid against the rights of a bona fide purchaser. Because § 545(2) applies only to liens that are unperfected and unenforceable, the debtors cannot avoid the SBE's lien under this section.

**C. The State's Lien Is Not Avoidable Under § 522(f)
Because The Statute Is Inapplicable To A
Statutory Lien On The Debtors' Residence**

The debtors' second argument is that the SBE's lien is avoidable under § 522(f) because it impairs the homestead exemption to which the debtors are entitled under Cal. Code Civ. Proc. § 704.730. Section 522(f) applies to avoid only two kinds of liens: (1) judicial liens on any kind of property; or (2) non-possessory, non-purchase money security interests in certain exempt personal property. 11 U.S.C. § 522(f). By its terms, § 522(f)(1) is inapplicable because the SBE lien arises statutorily rather than judicially; § 522(f)(2) is inapplicable because the section protects only certain exempt personal property that is subject to a purchase money security interest.

A tax lien is not a judicial lien that can be avoided under § 522(f). In re Audey, 66 Bankr. 52, 53 (Bankr. W.D. Pa. 1986), overruled on other grounds in In re McCullough, 122 Bankr. 251 (Bankr. W.D. Pa. 1990); In re Zerger, 35 Bankr. 42, 44 (Bankr. D. Or. 1983). An exception may arise where state law provides that a tax lien is to be treated as a judgment lien. See In re Frost, 111 Bankr. 306 (Bankr. C.D. Cal. 1990)(California law provides that a personal property tax lien under Cal. Rev. & Tax. Code § 2191.3 is treated as a judicial lien). California law provides that a tax lien for sales and use taxes, like the personal property tax lien in Frost, may be treated as a

1 judicial lien if the government obtains a judgment and records it. Cal. Rev. & Tax. Code § 6738.
2 However, that is not the case here; the SBE has not acquired a judgment against the Scotts for the
3 delinquent sales and use taxes. A non-possessory, non-purchase money security interest is
4 avoidable under § 522(f)(2) only in very limited circumstances. The property encumbered must fit
5 within the narrow description of exempt personal property enumerated in sections 522(f)(2)(A),
6 (B), and (C).³ In re Sweeney, 7 Bankr. 814, 818 (Bankr. E.D. Wis. 1980), aff'd on reh'g en banc
7 sub nom. In re Gifford, 688 F.2d 447 (7th Cir. 1982). Section 522(f)(2) does not apply to the
8 debtor's residence. In re Coonse, 108 Bankr. 661, 662 (Bankr. S.D. Ill. 1989). Further, §
9 522(f)(2) protects only certain exempt personal property subject to purchase money security
10 interests and cannot be invoked to avoid a statutory lien such as the SBE tax lien. In re Nelson,
11 92 Bankr. 837, 842 fn. 11 (Bankr. D. Minn. 1988). For the reasons stated, § 522(f) is
12 inapplicable to avoid the SBE's statutory tax lien.⁴

13 14 CONCLUSION

15 Based on the foregoing discussion, the debtors' motion to avoid the SBE's statutory tax
16 lien under §§ 545(2) and 522(f) is hereby denied.

17 Good cause appearing, it is SO ORDERED.
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22 ³The avoidance of non-possessory, non-purchase money security interests is limited to the following:

- 23 (A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or
24 jewelry that are held primarily for the personal, family, or household use of the debtor or dependent of the debtor;
25 (B) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or
26 (C) professionally prescribed health aids for the debtor or a dependent of the debtor.

27 ⁴Since § 522(f) is not applicable to the SBE's statutory tax lien, the Court need not reach the issues whether the attachment
28 of the SBE lien constitutes the "fixing" of a lien on an interest of the debtor in property, as discussed in Farrey v. Sanderfoot,
500 U.S. ___, 111 S. Ct. 1825, or whether the lien "impaired" the debtors' exemption as the term was discussed in In re Chabot,
992 F.2d 891, 895 (9th Cir. 1993).